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UNCLAS SECTION 01 OF 02 ISTANBUL 001449

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TREASURY FOR OASIA - MILLS AND LEICHTER
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E.O. 12958: N/A
TAGS: ECON EINV EFIN PGOV EINV EFIN PGOV TU
SUBJECT: WEIGHING CORPORATE TURKEY'S FOREIGN EXCHANGE RISK

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¶1. (SBU) Summary: Central Bank Governor Sureyya Serdengcti this month added his voice to those expressing concern about the risks to the Turkish economy posed by the growing open positions of companies in the real sector. Observers agree that while the Turkish banking sector-- whose own open positions in 2001 contributed to the depth of that year's banking crisis-- is now in a much more solid position, the real sector is increasingly exposed to foreign exchange risk. Recent Central Bank statistics show that at the end of the first quarter, 43 leading industrial companies had a net exposure of 4.3 billion USD, with ten leading firms accounting for three-quarters of that total, while the total exposure of the 214 companies on the Istanbul stock exchange was over 6 billion USD. Despite Serdengecti's warning, company officials downplay the risk, and many economists concur that worry about the issue is exaggerated. End Summary.

¶2. (U) Central Bank Concerns: Speaking to the Ankara Chamber of Industry on September 18, Serdengecti invoked a traditional Turkish proverb to warn companies in the real sector that "if you get burned by a risk you took knowingly, don't cry." He noted that while the banking sector currently has only limited exposure to foreign exchange risk because of its small open position, the growing open position of Turkish firms leaves them increasingly exposed to unforeseen movements in the lira's foreign exchange rate. He conceded that this is not a problem if the firm has foreign exchange earnings, but that if they do not, and are "seized by illusions," then they will be burned.

¶3. (SBU) An Angry Reaction: Industrial leaders did not react well to Serdengecti's counsel. Ibrahim Ozdogan, head of GISAD YK, commented that a country's central bank head should work first to provide confidence to the markets, and only then turn to offering advice, while leading exporter Ahmet Zorlu noted that his group has little foreign exchange exposure, but has been hurt by the dollar's decline. Suleyman Orakcioglu, head of the textile companies association IKTIB, emphasized that he did not wish to enter into a dispute with the Central Bank, but that his organization's key goal is to lower the price of exporters' inputs, given their current high level, despite the dollar's decline.

¶4. (SBU) Statistical backing: Recent statistics drawn both from Central Bank reports and company filings with the Istanbul Stock Exchange highlight the issue, though they provide contradictory indications about whether it has grown in scope in the recent past. Stock exchange figures show that 43 companies in the exchange's industrial index have a total foreign exchange exposure of 4.3 billion USD. Three-quarters of that total is held by just the ten largest firms. Moreover, Central Bank officials told Emboffs that the largest exposures were with the oil refiner Tupras and the petroleum distributor Petrol Ofisi. They expressed a lack of concern about these two companies' foreign exchange exposure given that they were in the dollar-linked oil business. The exposure increases only marginally when all 214 companies in the exchange are included, reaching a total of 6 billion USD. An analysis by Disbank's economic research team, however, shows that this total actually represents a decline from these firms' total exposure in the fourth quarter of 2002 (which then approached 7 billion USD). Interestingly, while there has been a steady (albeit gradual) decline in the exposure of firms with foreign investment since the second quarter of 2002, the exposure of firms without foreign investment shot up at the end of that year, and has only now begun to decline gradually.

¶5. (SBU) Varying Motives: Historically, much of corporate Turkey's borrowing has taken place offshore, given high interest rates on Turkish lira loans. (Even today real rates are hovering in the 12-14 percent range on short term instruments, well above comparable dollar or Euro rates). Companies thus traditionally borrow at low interest rates in foreign currency, and then either import inputs or convert the loan into lira for domestic consumption or investments. As Serdengecti noted, the degree of risk to which they are exposed depends on the use to which they put the loan, and whether they have a natural hedge in the form of foreign currency earnings.
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¶6. SBU) How Significant?: Given these varying motives and risk factors, analysts and economists are divided on the significance of the issue. Vural Akisik, Chairman of the board of Petrol Ofisi, which has one of the largest open positions among Turkish companies (but is in a dollar-linked industry), argued that the total open position figure is not particularly meaningful, given that companies open positions for many reasons. If the open position is financing a capital import, he argued, which will be used to generate a foreign currency income stream, this is less of a problem than if it is financing a consumption or intermediary good. Unfortunately, however, there are no good figures available which separate out what percentage of foreign exchange borrowings are being used for this purpose. Akisik concurred that if companies are using the funds to invest in treasury bills, as banks did before the last crisis, they would be exposed to significant risk in the event of a correction. Given that few foreign banks would extend credits for such a purpose, however, he saw this risk as being limited. Ersin Ozince, CEO of Isbank, similarly argued that the largest exchange rate challenge facing Turkey's real sector is not that posed by its open position, but that posed to its competitiveness. He cited the example of the Is company that produces soda ash for glass production, noting that it is currently cheaper to import that raw material from abroad than to produce it in Turkey.

¶7. (SBU) A Mixed Bag: Investment analysts largely agree that the open position problem is not at a critical level. A recent analysis by ATA Invest, one of Istanbul's largest brokerages, noted that many companies are largely hedged against recent foreign exchange developments because while their exports are largely denominated in Euros, which has moved less against the lira, their raw material inputs and even some local purchases are dollar denominated. For those companies with largely Turkish lira income flows, recent exchange movements will benefit them in the short term. Hence, in ATA's view, the dollar debts of Turkcell and Petrol Ofisi should give those companies large FX gains in the second quarter, though of course exposing them to FX losses if there is a correction. ATA noted that most firms' debts were to finance inputs, but did highlight two companies, Cimsa and Migros, a large food retailer, which had placed their liquid assets in TL instruments (a long-standing tradition in the fast-moving retailing sector, where profit has typically stemmed more from cash-flow management than core operations.)

¶8. (SBU) Comment: Most analysts agree that the current situation is less worrisome than that which preceded the last crisis, in that the banking system itself no longer is at risk; instead, specific companies have put themselves at the mercy of the foreign exchange rate. Bender analysts Emin Ozturk and Murat Gulkan make one noteworthy caveat to this reassuring picture, however: given that banks and real sector firms coexist inside the same large holdings, it can be argued that some holdings have simply moved their foreign exchange games from a sector where they are now forbidden by regulatory rules (the banks) to one where there is less supervision (the real sector). But given the natural hedge of foreign currency income, and the fact that a not insignificant part of the exposure is related to capital goods purchases, the overall problem looms less large than it did in the past. Beyond this, many see no reason for a lira correction in the near to mid-term; indeed some commentators have even outlined scenarios where the lira could reach 1.3 million to the dollar or higher. End Comment.
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